No. 82-1121

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

LOUISIANA PUBLIC SERVICE COMMISSION,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION
and MIDDLE SOUTH SERVICES, INC.
Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

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OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

Of Counsel:
WILLIAM D. MERIWETHER, JR.
Vice President and
General Counsel
Middle South Services, Inc.
225 Baronne Street
P.O. Box 61000
New Orleans, LA 70160

RICHARD M. MERRIMAN*
ROBERT S. WATERS
REID & PRIEST
Suite 1100
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-0100
Attorneys for Respondent Middle South Services, Inc.
**Counsel of Record*

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D.C.

QUESTION PRESENTED

Whether the court of appeals correctly found that there was substantial evidence to support the facts relied upon by the Federal Energy Regulatory Commission to decide a wholesale electric rate case, and gave appropriate deference to that agency's expert judgment in affirming its ratemaking method.

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Middle South Services, Inc. (MSS),[1] intervenor in support of respondent Federal Energy Regulatory Commission (FERC) in the case before the Court of Appeals for the Fifth Circuit and the applicant before the FERC, submits this brief in opposition to the petition for writ of certiorari.

[1] The list of parties to the proceeding supplied by petitioner is correct. In accordance with Rule 28.1 of this Court, a complete listing of all parent companies, subsidiaries and affiliates of respondent Middle South Services, Inc. follows: Middle South Utilities, Inc. (MSU), a registered public utility holding company, is the parent company of, and owns all the common stock in, Middle South Serv-

OPINIONS BELOW

The references to the opinions of the court of appeals and the FERC set forth in the petition are correct.

JURISDICTION

The petition correctly states the grounds on which the jurisdiction of the Court rests.

STATUTORY PROVISIONS

In addition to the provisions cited by petitioner, Section 313(b) of the Federal Power Act, 16 U.S.C. § 825*l*(b), is involved in this case. That section provides in pertinent part that upon review by a court of appeals,

> [t]he finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive.

The full text of Section 313(b) of the Federal Power Act is set forth in the Appendix hereto.

STATEMENT OF THE CASE

Petitioner seeks review of an opinion of the Court of Appeals for the Fifth Circuit affirming a decision of the FERC approving in part and modifying in part a wholesale electric rate change filed by MSS under Section 205 of the Federal Power Act, 16 U.S.C. § 824d. The rate approved by the FERC is for interstate sales of power

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ices, Inc. (MSS) and four electric utility operating companies: Louisiana Power & Light Company, Arkansas Power & Light Company, Mississippi Power & Light Company, and New Orleans Public Service, Inc. Among other things, MSS acts as an agent for these MSU subsidiaries in various regulatory matters.

Three other associated companies are System Fuels, Inc., Middle South Energy, Inc., and Associated Natural Gas Company.

among four affiliated electric utilities that together operate a physically integrated and centrally dispatched electric power system, or pool, known as the Middle South System.[2] The order of the FERC increased the allowance for a rate of return on common equity capital and expanded the categories of expenses that are subject to various automatic adjustment clauses under the System Agreement among the companies. The System Agreement was first approved by the Federal Power Commission (FPC) on June 29, 1973.

a. Course Of Proceedings

This case began in 1979 with the filing by MSS of certain rate change amendments to the System Agreement originally approved by the FPC in 1973. Under the 1973 System Agreement, certain types of expenses were subject to automatic adjustment clauses. MSS proposed to expand the categories of expenses subject to the automatic adjustment clauses, and also to increase the rate of return on equity.

The FERC allowed the amendments to become effective subject to refund, and a hearing was held by the FERC to consider the justness and reasonableness of the proposed changes. MSS, the FERC trial staff, the State of Arkansas, the Arkansas Public Service Commission and the Louisiana Public Service Commission (petitioner herein) participated at the hearing. On November 13, 1980, an administrative law judge issued an initial decision that permitted the expansion sought by MSS of the

[2] The four electric utilities, all subsidiaries of MSU, are listed in footnote 1 above. Together they will be referred to for convenience as the Middle South System or the MSU operating companies.

automatic adjustment clauses, but on condition that MSS file annual cost reports.

Exceptions to the initial decision were taken and briefs were filed with the FERC which, on June 30, 1981, modified and affirmed the initial decision. The FERC agreed with the administrative law judge and authorized expansion of the cost adjustment clauses (previously approved in 1973) to include the costs of operation and maintenance, and general and administrative overheads after they had been incurred and recorded. These cost items had previously been *estimated* in pricing the sales of power among the MSU operating companies. However, the FERC dispensed with the annual cost reports that the administrative law judge had wanted, and instead specifically approved the formulae in the clauses as the filed rate.[3]

Petitioner sought review in the Court of Appeals for the Fifth Circuit which, on October 4, 1982, found that the FERC's decision was supported by substantial evidence and resulted in a just and reasonable rate that did not unduly discriminate against ratepayers, and accordingly affirmed. Specifically, the court held that the FERC's decision to expand the scope of the automatic adjustment clauses in this case was not invalid, affirmed the FERC finding that good cause had been shown to support an exception to the general notice requirement of Section 205 of the Federal Power Act, 16 U.S.C. § 824d, and affirmed the FERC decision as to rate of return on equity.

On December 30, 1982, petitioner filed a petition for writ of certiorari in this Court. MSS sought and was

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[3]The FERC also increased the rate of return allowed by the administrative law judge, an issue not raised by petitioners in this Court. .

granted an extension of time to and including February 14, 1983, in which to respond to the petition.

b. Statement Of Facts

The System Agreement, approved by the Federal Power Commission as the operating tariff in 1973, provided the contractual framework by which the four MSU operating companies are enabled to obtain the economic, operational, reliability, safety, engineering and environmental benefits of reserve sharing,[4] large power plant construction, and centralized dispatching of power from plants located in a four state area.[5]

Under this arrangement, from time to time a MSU-owned operating company had the responsibility of constructing, owning and operating a new generating unit of sufficient size to achieve economies of scale. Any such new "participation unit" would ultimately be needed to meet the native load requirements of the individual operating company. However, until the time the load growth of the owning company could absorb the total capacity of the new plant, its output and associated costs were to be shared with the other operating companies.

> Section 3.01 of the System Agreement provides
>
> a basis for equalizing among the Companies any imbalance of costs associated with the construction,

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[4] *See* Gainesville Utilities Dept. v. Florida Power Corp., 402 U.S. 515, 518-20 (1971), for a discussion of the reserve sharing concept and its desirability.

[5] *See* Indiana & Michigan Electric Co., 33 FPC 739, 743 (1965), *aff'd*, Indiana & Michigan Electric Company v. FPC, 365 F.2d 180, 181-82 (CA7), *cert. denied*, 385 U.S. 972 (1966), for a helpful description of a physically integrated and centrally dispatched electric power system similar to the MSU system.

ownership and operation of such facilities as are used for the mutual benefit of all the Companies.

Pursuant to the System Agreement, the MSU operating companies share in the costs of the designated participation units and related extra high voltage transmission facilities according to their individual system load responsibilities. The balancing of generating costs occurs under Service Schedule MSS-1 "Capability Equalization," while the balancing of transmission costs is achieved under Service Schedule MSS-2 "Transmission Equalization." Thus, operating companies that own less generating or transmission capability than their existing load responsibilities would otherwise require (termed "short" or "buying" companies) must pay a capacity or transmission equalization charge to the operating companies that own more generating or transmission capability than needed to serve their customers (termed "long" or "selling" companies).

These tariffs are designed to operate as a short term cost equalization mechanism so that "long" companies, and therefore their ratepayers, are compensated by the "short" pool members for supplying power from large scale units to meet the "short" companies' needs. However, once the "long" company's load growth absorbs the total capacity of its plant the entire benefit of economies of scale goes to that company and its customers. Typically such load growth matches the installed capacity in less than four years, and shortly thereafter the once "long" company will become a "short" or buying company.

By filing certain rate revisions to Service Schedules MSS-1 and MSS-2, the MSU operating companies have sought to place operation, maintenance, and general and administrative expenses under the automatic adjustment formulae, thereby making all costs (except cost of equity

which remains fixed) subject to both increases and decreases. Such a tariff is called a full cost of service tariff.

SUMMARY OF ARGUMENT

Far from presenting "an important regulatory issue arising in the special context of federal preemption of state regulatory alternatives," petition at 10, this case raises the routine question whether there was substantial evidence to support the decision of the FERC in a wholesale electric rate case.

The court of appeals applied the correct standard of review to the FERC decision and gave appropriate deference to the FERC's expert judgment in approving a ratemaking method or formula. On the merits, its decision is consistent with those of other courts of appeals that have considered similar questions.

When the FERC approved the full cost of service tariff in this case its action was consistent with federal law, with its past practice and with its stated criteria for granting approval to such tariffs. The Congress has expressly recognized the power of the FERC to approve formula rates. Far from being unjust or unreasonable such rates assure that the seller gets that which he is entitled to and no more, and that the consumers receive rate relief at the time cost decreases are experienced. That the FERC has approved a rate which Louisiana does not like is a straightforward matter for review under the substantial evidence test.

The decision of the court of appeals is correct and does not conflict with the decisions of this Court or the decisions of any other court of appeals. Moreover it does not depart from the accepted and usual course of judicial proceedings, and does not present a question of federal law that requires decision by this Court.

ARGUMENT

a. The court of appeals correctly identified and applied the appropriate standard of review:

> A litigant seeking to overturn a rate decision of FERC must make a "convincing showing that it is invalid because it is unjust and unreasonable under the circumstances." *FPC* v. *Hope Natural Gas Company*, 320 U.S. 591, 64 S.Ct. 281, 288, 88 L. Ed. 333 (1944); *United Gas Pipe Line* v. *FERC*, 618 F.2d 1127, 1131 (5th Cir. 1980). In reviewing a decision by FERC, this Court is "without authority to set aside any rate selected by the Commission which is within a 'zone of reasonableness.' " *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 88 S.Ct. 1344, 1360, 20 L.Ed.2d 312 (1968) (quoting *FPC* v. *Natural Gas Pipeline Company*, 315 U.S. 575, 62 S.Ct. 736, 743, 86 L.Ed. 1037 (1942). Additionally, FERC is not "bound to a single rate making method or formula, but is free to make pragmatic adjustments in it's methods." *Arkansas Louisiana Gas Co.* v. *FERC*, 654 F.2d 435 (5th Cir. 1981). Moreover, in reviewing the facts relied upon by FERC in reaching its decision, this Court must only decide whether the facts relied upon by FERC are supported by substantial evidence. 16 U.S.C. § 825*l*(b) (1976); *In re Permian Basin Area Rate Cases*, 88 S.Ct. at 1372.

Appendix, A-27; 688 F.2d 357, 359-60 (CA5, 1982). The court of appeals found ample support in the past practice of the FERC and congressional recognition thereof in Section 208 of the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 824d(f), for the use of an automatic adjustment formula to operate as a rate.

With respect to past practice of the FERC, the court of appeals noted that in *Central Power and Light Co.*, 11 FERC ¶ 61,102 (1980), the FERC decided that the use of automatic adjustment clauses in full cost of service tariffs was appropriate for unit sales and sales to affiliates, and

that the usual notice requirement of Section 205 of the Federal Power Act, 15 U.S.C. § 824d, should be waived for good cause in such cases. The court of appeals was persuaded by the FERC's reasoning that such rates were just and reasonable because they allow both upward and downward adjustments and assure ratepayers of only paying for actual increases and decreases in costs, and because the sales in this case are between affiliates operating on a pool basis.[6] The court of appeals also noted the FERC's reliance on routine FERC audits to discover any possible inaccuracies and, finding substantial evidence to support the FERC's decision that good cause existed in this case to waive the usual notice requirements of Section 205, affirmed FERC's expert judgment that a full cost of service tariff was appropriate, just and reasonable for the Middle South System.

In response to petitioner's argument that such tariffs were either against the law or against strong federal policy, the court of appeals found to the contrary that they were expressly permitted by federal statute, 16 U.S.C. § 824d(f), and had been discussed by the House and Senate conferees who, in the Conference Report, expressly did "not indicate any preference for inclusion or exclusion of any item in an automatic adjustment clause." H.R. Rep. No. 95-1750, 95th Cong., 2d Sess. 96, *reprinted in* 1978 U.S. Code Cong. & Admin. News 7659,

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[6] The practical effect of the System Agreement is to allocate the costs incurred within the MSU System to those consumers who have received the benefits of comprehensive power pooling. The System Agreement cannot be used to improve the net earnings of the MSU System, which is consolidated, because a debit to one affiliated company works an automatic credit to the other. Accordingly the effect of any automatic adjustment under the cost of service tariffs in this case is zero on the companies as a whole.

7830, (quoted by the court of appeals at Appendix, A-28, 688 F.2d at 360). Recognizing that the FERC's order was "the product of expert judgment which carries a presumption of validity . . ." (quoting *FPC* v. *Hope Natural Gas*, *supra*), the court of appeals affirmed the decision to use the automatic adjustment clause. Appendix, A-28, 688 F.2d at 360.

b. The FERC's approval of a full cost of service tariff in this case represents no new or novel departure from its past practice or sound regulatory policy.

The FERC uses two distinct methodologies in electric utility rate setting. The first and more common approach produces a fixed charge based on a company's estimated cost of service. The second adopts what is called a formula, or cost of service, rate into which changing levels of costs are automatically entered to produce the service charge. One or the other of these two methodologies is used depending on the nature of the sale.[7]

A cost of service tariff, which is the kind of rate approved by the FERC in this case, simply passes

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[7] When an electric utility agrees to sell electricity, it may contract to sell the electricity from a designated generating resource or, alternatively, from the total amount of electricity that it has from all of its sources. The more common arrangement is the latter, *i.e.*, a general system sale, and typically the rate is fixed at a level based on estimated costs. This fixed charge is necessarily based on estimated costs because it is so difficult to track in a timely manner the enormous number of variables in the recorded costs on a system-wide basis. Lacking a more precise method, utilities and regulators rely on predetermined, fixed rates based on the utility's average costs for service during a designated "test" period, usually 12 months. In contrast to general system sales, when the sale is made from a designated generation unit it is quite possible to achieve better, *i.e.* more accurate, ratemaking through the use of a formula rate that results in a cost of service tariff.

through the actual costs as they are incurred by the designated generation unit and are recorded on the utility's books of account. The utility's books, of course, are subject to routine periodic audits by both state and federal regulators. As noted by the court below, under this methodology the formula itself, rather than an estimated charge, constitutes the utility's filed rate. Appendix, A-30; 688 F.2d at 361. *Accord, Public Service Company of New Hampshire* v. *FERC*, 600 F.2d 944, 947-48 (CA D.C.), *cert. denied*, 444 U.S. 990 (1979). As the costs change, either upward or downward, they are automatically factored into the formula to calculate the unit charge for service without the need for additional filings before the FERC. As long as the formula tracks any decreases as well as increases, the FERC has concluded that it can be assured the company will collect no more than its actual cost of doing business. Furthermore, the FERC has decided that such full cost of service tariffs are appropriate for use in rate making for sales from specifically designated units ("unit sales"), for sales between affiliated companies, and for power pool transactions. *Central Power & Light Co., supra.*

Those courts that have considered formula rate clauses, such as a fuel adjustment clause,[8] have recognized that there is no statutory impediment to having a formula operate as the filed rate, and that there need be no filing with the FERC to reflect fluctuations in costs provided the changes were calculated in accordance with the formula. *Public Service Company of New Hampshire*

[8] The theoretical justification underlying this form of rate design does not depend on whether the formula tracks only a few costs such as fuel or taxes (as was the case before MSS filed to amend the rate in this proceeding) or nearly all costs (excluding cost of capital, which is more judgmental) as in a full cost of service tariff such as approved by the FERC in this case.

v. *FERC*, *supra*, 600 F.2d at 947.[9] And without exception the courts have held that approval of an electric utility's choice between fixed and formula rates, or types of formula rates, is a matter for the FERC. *Id.* at 959.

To be contrasted with a cost of service formula, which requires both upward and downward adjustments based on recorded cost experience, is an escalator clause. The latter typically raises the price of the service at fixed intervals by a predetermined amount (the escalator) regardless of whether such an increase is otherwise justifiable, or whether the resulting rate in any way matches the increase (or decrease) in costs. Escalator clauses have generally been disapproved. *See, e.g., Episcopal Theological Seminary* v. *FPC*, 269 F.2d 228, 234 (CA D.C.), *cert. denied*, 361 U.S. 895 (1959) (Natural Gas Act); *Sunray Mid-Continental Oil Co.* v. *FPC*, 364 U.S. 137, 153 (1960) (dictum under the Natural Gas Act).

This distinction between escalator clauses and formula rates or cost of service tariffs has routinely been drawn by the FERC: escalator clauses do not necessarily match rate increases to actual cost increases, whereas cost of service tariffs match rates and costs with considerable precision.[10] It is this distinction that petitioner misses when it insists that the present case marks a radical departure from past law and practice.

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[9] *Accord*, Jersey Central Power and Light Co. v. FERC, 589 F.2d 142 (CA3, 1978), *cert. denied*, 444 U.S. 880 (1979); Virginia Electric and Power Co. v. FERC, 580 F.2d 710 (CA4, 1978); Maine Public Service Company v. FPC, 579 F.2d 659 (CA1, 1978).

[10] Indeed, at least one court has suggested that, in the interest of accurate cost recovery, perhaps the FERC should "permit only cost of service tariffs," Public Service Company of New Hampshire v. FERC, *supra*, 600 F.2d at 959.

Petitioner's assertion that the rationale offered by the FERC to justify cost of service tariffs for sales to affiliates is inadequate rests on a misunderstanding of the FERC's reasoning. In this case the cost of service tariff is appropriate under each of the FERC's usual justifications: first, the transactions under the tariff involve sales from designated generation units (those that belong to the "long" companies); designated unit sales offer the clearest example of an appropriate occasion for a cost of service tariff because costs directly attributable to that unit may be identified. Second, because both the buying and the selling companies covered by the tariff are affiliates (in this case wholly owned subsidiaries of MSU, the parent holding company) there is no incentive for undercharging or overcharing; similarly there is no incentive to correct mistaken estimates upon which a fixed charge rate necessarily rests. Indeed, in the case of affiliate sales the FERC has long insisted on the use of cost of service tariffs to ensure that cost decreases, as well as increases, are passed on to the consumers.[11] As additional insurance against unjust or unreasonable rates, the FERC requires that formula rates be expressly considered and explicitly approved as the filed rate (as opposed to being casually accepted as part of a contract filed by the utility with the FERC) before any changes under the clause can be put into effect as exceptions to the notice and review provisions of the Federal Power Act. *Central Power & Light Co.*, *supra* (distinguishing *Sunray Mid-Continental Oil Co.* v. *FPC*, *supra*). Against these clear justifications and safeguards petitioner repeats its speculations about

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[11] American Louisiana Pipe Line Co. and Michigan Wisconsin Pipe Line Co., 29 FPC 932, 935-36 (1963), *rev'd and remanded on other grounds*, American Louisiana Pipe Line Co. v. FPC, 344 F.2d 525 (CA D.C., 1965).

imprudently incurred costs. These have already been offered both to the FERC and to the court of appeals.

c. Petitioner suggests (petition at 22-25) that "federalism concerns" and state preemption cases require Supreme Court review of this case. It may be true that the Louisiana Public Service Commission does not approve of the result reached by the FERC; but such disapproval at most reflects nothing more serious than the inevitable tension between two sovereigns in our federal-state dual system of government. While such tensions must be treated respectfully, and have been so treated below, the Supremacy Clause dictates the outcome in this case. In any event, petitioner's threat that "state commissions may have good reason to test the limits of the preemption doctrine by disallowing or adjusting the expenses," petition at 24, will be more appropriately dealt with, should the occasion ever arise, by the lower federal courts in the first instance; it presents no new or novel question for this Court. *See New England Power Co.* v. *New Hampshire*, 445 U.S. 331, 340-43 (1982), and cases therein cited.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

MIDDLE SOUTH SERVICES, INC.

RICHARD M. MERRIMAN*
ROBERT S. WATERS
REID & PRIEST
Suite 1100
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-0100

Attorneys for Respondent Middle South Services, Inc.
**Counsel of Record*

Of Counsel:
WILLIAM D. MERIWETHER, JR.
Vice President and
General Counsel
MIDDLE SOUTH SERVICES, INC.
225 Baronne Street
P.O. Box 61000
New Orleans, LA 70160

Dated: February 14, 1983

APPENDIX

The full text of Section 313(b) of the Federal Power Act, 16 U.S.C. § 825*l*(b), follows:

> (b) Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the United States Court of Appeals for any circuit wherein the licensee or public utility to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of Title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonble ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or

setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 346 and 347 of Title 28.